

**IOSCO's Consultation Paper on Risk
Mitigation Standards for Non-centrally
Cleared Derivatives**

Our answer to your consultation

Deutsches Aktieninstitut¹ welcomes the opportunity to comment on the IOSCO's consultation paper on risk mitigating techniques regarding non-centrally cleared derivatives. Our comments represent the view of non-financial companies using derivatives almost exclusively for risk-mitigating purposes and, hence, not being obliged to clear.

According to the European derivatives regulation EMIR, non-financial companies already have to comply with risk mitigating techniques, especially timely trade confirmation, portfolio reconciliation, portfolio compression and dispute resolution. The implementation of these requirements has been very cost-intensive and resource-binding. Therefore, new global standards on risk mitigating techniques should not contradict standards already adopted, especially those under EMIR. Otherwise, implementation costs would be multiplied. For the same reason, details of the risk management standards like deadlines, frequencies or definitions should not be further specified by IOSCO.

Our comment focuses on the following aspects:

1) Scope of Coverage

We welcome the intention of IOSCO to cover only financial entities and systemically important non-financial entities. For the latter, IOSCO should clarify that non-financial companies which are exempt from clearing and collateral obligations will never qualify as systemically important. This would be in line with the scope defined in the BIS / IOSCO standards regarding bilateral collateralization.

Furthermore, IOSCO encourages "covered entities" to apply the proposed standards in their transactions even with other entities. As this would increase operational burdens for counterparties that, by definition, do not pose a risk for the financial system such transactions should remain out of scope. In most cases such entities would be smaller non-financial companies that are using derivatives only to reduce risks from their operative businesses.

¹ Deutsches Aktieninstitut represents the entire German economy interested in the capital markets. Its about 200 members are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt am Main, Brussels and Berlin.

2) Trade Confirmation

We appreciate that IOSCO acknowledges the limits of confirmations which are electronically processed. For certain transactions electronic confirmation is not available or not appropriate from a cost-benefit perspective. Therefore, it is very important that confirmations via fax, e-mail etc. continue to be acceptable. This includes negative affirmation, which is widely used for internal transactions of non-financial companies to reduce operative burdens.

Globally agreed standards should not be too detailed and should not define the period within which the confirmation would have to be completed. This would bear the danger of contradicting already existing confirmation periods, e.g. under EMIR, and is very likely to further increase implementing costs. Even worse, such timing requirements may need to be adapted due to future changes in other regulations.

The requirement to report unconfirmed transactions to the relevant authorities should be restricted to financial counterparties, as this is, e.g., the case under EMIR. Due to their experience with different regulations, financial companies are more familiar with reporting requirements and have the processes and structures available.

3) Valuation with Counterparties

Mark-to-market valuation is not a common practice among non-financial counterparties as it does not offer any intrinsic value for hedging transactions which would never be terminated solely due to value development. Especially SMEs using derivatives to mitigate risks related to their operative business do not apply market valuations. Where required for accounting purposes they refer to market values provided by the sell side. This is the main reason why EMIR restricts the requirement for daily market valuations to financial counterparties and non-financials exceeding the clearing thresholds. This should be taken into account by IOSCO as well.

4) Reconciliation

Reconciliation of market values should be restricted to those companies which are required to exchange collateral. Otherwise, the effort would be lacking any operational reason. Therefore, for non-financials not exceeding the clearing thresholds a reconciliation of market values is not meaningful.

5) Portfolio Compression

We agree with IOSCO that portfolio compression will not always be appropriate. This is especially the case for derivatives used by non-financial counterparties for risk-mitigating purposes as these instruments are, in general, held until maturity, subject to adjustments in case the underlying business or market expectations change. As long as there is an underlying business, there is no reason for a portfolio compression which is processed to eliminate redundant contracts, simply because there are no such contracts. Even worse, eliminating “similar” or offsetting contracts will in many cases create problems with regard to hedge accounting treatment. We again reiterate we would not advise to add more detail to this chapter with regard to thresholds or frequencies to avoid collisions with comparable rules in other jurisdictions.

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